Supreme Court, U.S.
FILED
SEP 24 1996
CLERK

No. 96-29

In The

Supreme Court of the United States

October Term, 1995

NORTHERN STATES POWER COMPANY,
a Minnesota corporation, and
NORTHERN STATES POWER COMPANY,
a Wisconsin corporation,

Petitioners,

vs.

UNITED STATES OF AMERICA,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Eighth Circuit

PETITIONERS' REPLY TO BRIEF IN OPPOSITION

STEVEN Z. KAPLAN
Attorney of Record
RICHARD D. SNYDER
FREDRIKSON & BYRON, P.A.
1100 International Centre
900 Second Avenue South
Minneapolis, MN 55402
(612) 347-7000

Of Counsel:
DAVID A. LAWRENCE
Northern States Power Company
414 Nicollet Mall
Minneapolis, MN 55401
(612) 330-5500

Attorneys for Petitioners Northern States Power Company

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

13 pp

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES i

INTRODUCTION 1

DISCUSSION 3

I. The Government's "Plain Meaning" Construction Rests Upon an Unexplained, Unfounded, and Erroneous Assumption. 3

II. The Government Has Failed to Address the Conceptual Conflict Between the Eighth Circuit and Seventh Circuit. 7

CONCLUSION 9

TABLE OF AUTHORITIES

Page

FEDERAL CASES

Bob Jones University v. U.S., 416 U.S. 574 (1983) 6

In Re Pettibone Corp., 161 B.R. 960 (N.D. Ill. 1993) 9

Pettibone Corp. v. U.S., 34 F.3d 536 (7th Cir. 1994) ...*passim*

U.S. v. Goodyear Tire and Rubber Co., 493 U.S. 132 (1989) 6

U.S. v. Hill, 113 S. Ct. 941 (1993) 1

FEDERAL STATUTES

Internal Revenue Code of 1986, as amended, 26 U.S.C.

§ 41(a) 4

§ 46 4

§ 6402(a) ..... *passim*

§ 6601(f) ..... *passim*

Tax Reform Act of 1986, P.L. 99-514, 100 Stat. 2085

§ 1511(a) 9

§ 1511(b) 7, 9

TREASURY REGULATIONS

Treas. Reg. § 301.6402-1 ..... 3, 4

REVENUE PROCEDURES

Rev. Proc. 60-17, 1960-2 C.B. 942 1

INTRODUCTION

The government's opposition to NSP's petition does not dispute that the netting conflict between taxpayers and the IRS is a question of such immense impact that, like the alternative minimum tax issue reviewed in *U.S. v. Hill*, 113 S. Ct. 941, 945 (1993), the "importance . . . to the federal fisc" alone merits certiorari. The government apparently concedes that the sums at stake for taxpayers nationwide and the Treasury are enormous.

The government's opposition also does not dispute either that the Internal Revenue Code embraces the "use of money" concept as the overriding principle governing interest obligations or that the objective of this principle is "to determine in a given situation whose money [has been used] and for how long the other party had the use of it." Rev. Proc. 60-17, § 2.01(1), 1960-2 C.B. 942. Likewise, the government never contests that interest netting is an accounting method which applies the "use of money" concept with mathematical exactitude and complete economic rationality.

Rather, the government's opposition rests entirely on the argument that the Eighth Circuit's statutory construction is analytically correct. However, the government assumes without foundation that the interest netting "credit" referenced in § 6601(f) must be restricted in its scope to the debt collection "credit" referenced in § 6402(a). In blithely assuming that the netting "credit" of § 6601(f) simply mirrors the debt collection "credit" of § 6402(a), the government misconstrues these statutes and ignores their respective purposes and functions. Contrary to the government's assumption, Congress' purpose

in enacting § 6601(f) in 1958 was to implement the "use of money" principle by requiring netting to alleviate any interest obligation disparities whenever a taxpayer had simultaneous overpayments and underpayments. Section 6601(f) uses the word "credit" in the broad accounting sense of an entry which is made solely to offset a liability which would otherwise exist but for the "credit."

Because their analysis goes no further than to assume that Congress' use of the word "credit" in § 6601(f) references only a § 6402(a) credit, both the government and the Eighth Circuit have disavowed any consideration of the reasons why each statute was adopted, the essential purposes which each was intended to serve, and how each fits within the Code to foster those purposes. Consequently, the government and the Eighth Circuit overlook the absurdities and anomalies which result from their interpretation of these statutes because, no matter how serious or harsh these results may be, they are purportedly compelled by the cold language of the statutory words. Reading the statutory words in a complete vacuum has led the government to argue, and the Eighth Circuit to agree, that Congress has not only failed to legislate against the identifiable harm suffered by taxpayers, but, indeed, that Congress has expressly granted the IRS broad discretion either to harm every taxpayer or, alternatively, to spare some while afflicting others. The merits of the parties' respective arguments aside, this Court should review the decision below to clarify whether tax statutes can ever be read for their assumed "plain meaning" without making any inquiry into statutory purpose or legislative intent.

Lastly, the government has embraced the Eighth Circuit's erroneous interpretation of the Seventh Circuit's decision in *Pettibone* in an effort to avoid the conflict with that decision. NSP takes this opportunity to further explain why an irreconcilable conflict is inherent in the two decisions.

DISCUSSION

I. The Government's "Plain Meaning" Construction Rests Upon an Unexplained, Unfounded, and Erroneous Assumption.

The government's first ground for opposing certiorari is that the Eighth Circuit correctly held that (1) interest netting under § 6601(f) can never be triggered unless the IRS collects a currently "outstanding" debt by means of a § 6402(a) collection setoff and (2) interest netting under § 6601(f) is never mandatory or self-executing but is, instead, wholly discretionary with the IRS because § 6402(a) is facially discretionary. This aspect of the government's opposition not only begs the question of whether the words of the Code can ever be read only with regard to what the reader *believes* some dictionary definition to require, but it is also grounded upon a demonstrably false premise.

The false premise is the government's attempt, entirely without explanation, to equate the meaning of the word "credit" as used in § 6402(a) with the meaning of the word "credit" as used in § 6601(f). The government's analysis begins with observing that § 6402(a) and Treas. Reg. § 301.6402-1 permit the IRS to "credit" an

overpayment against an underpayment. Next, the government notes that § 6601(f)'s interest netting provisions apply when the "credit" of an overpayment satisfies an underpayment. The government then assumes and declares that the "credit" referenced in § 6601(f) can only mean the debt collection "credit" referenced in § 6402(a) and Treas. Reg. § 301.6402-1. The government's premise is, however, neither analytically nor historically correct.

First, the word "credit" as used in the Code has different meanings, depending upon the context and purpose for which it is being used. In the § 6402(a) context of the collection of a still unpaid and "outstanding" debt, the word "credit" means the bookkeeping entry that the IRS makes on its internal taxpayer accounts when it *transfers funds* from one tax liability account which is overpaid to another liability account which is underpaid. For debt collection purposes, the § 6402(a) "credit" references only this internal, administrative transfer of funds.

The word "credit," however, is used throughout the Code with a far broader meaning than the "collection" transfer crediting exercise in § 6402(a). For tax law and tax accounting purposes, the word "credit" also means *any* accounting or bookkeeping entry that reduces or offsets a liability that would otherwise be owed, but for the "credit." For example, a taxpayer may be entitled to an investment tax credit or a research tax credit, each of which is a "credit" that satisfies or reduces an otherwise owed tax liability. *See* §§ 46 and 41(a) of the Code. Unlike a "collection"-type credit, these "credits" do not represent funds which are physically transferred from the

taxpayer to the IRS or from one IRS account to another. They exist solely as an "on paper" accounting or bookkeeping entry on a taxpayer's return. They are accounting credits which are purely computational reductions of a liability.

Similarly, in the context of interest computations, the word "credit" in § 6601(f) is simply a reference to any overpayment which offsets an underpayment for the purpose of determining which party had the use of how much of the other party's money and for how long. This is so because interest netting is purely an *accounting method* for purposes of combining multiple tax liability accounts into one aggregate, combined, and chronological account, with interest owed, to one party or the other, only on the net running balance. *Pettibone Corp. v. U.S.*, 34 F.3d 536, 538-39 (7th Cir. 1994). In short, interest netting is merely the accounting method used to implement a "use of money" calculation. No transfer of funds between accounts is necessary. For such reason, the "credit" which triggers § 6601(f) interest netting is any overpayment which simultaneously existed at the time of any underpayment. Whether the underpayment is later paid or remains still "outstanding" for collection purposes at the time the interest computation is being made is irrelevant to whether an overpayment and underpayment had simultaneously existed in the past for interest obligation purposes.

Second, the respective histories underlying §§ 6402(a) and 6601(f) demonstrate that § 6601(f) is not merely a captive of debt collection setoffs. The IRS has performed debt collection setoffs under § 6402(a) and its predecessor statutes since the 1930s, long before 1958 when Congress

first enacted interest netting in § 6601(f). When Congress enacted § 6601(f), its purpose had nothing whatever to do with § 6402(a) debt collection setoffs. Rather, in enacting § 6601(f), Congress sought to implement strict "use of money" crediting concepts into all interest computations.

As the pre-1958 cases cited in the petition reflect, in enacting § 6601(f) Congress was concerned with curing the anomalous departures from the "use of money" concept that had arisen in such cases as when taxpayers had simultaneously overpaid and underpaid certain types of tax obligations or when taxpayers were receiving interest on an overpayment of one tax liability for a period of time during which the IRS was prohibited from collecting interest on an underpayment of another tax liability. (Petition at 9). None of the circumstances which necessitated § 6601(f) involved a § 6402(a) debt collection offset. Each of the cases cited was a refund suit, like NSP's, in which all amounts had been fully paid as required before the refund suit could be brought. No "outstanding" underpayment remained owing at the time of suit. In no case was the fact of full payment, and the resulting inability of the IRS to collect an "outstanding" liability by means of an administrative setoff, treated as in any way relevant to, let alone determinative of, whether or not interest should be computed with netting.

Only by a wholesale disregard for the purpose of § 6601(f) and a refusal to engage in the type of analysis required by this Court in the cases such as *Bob Jones University v. U.S.*, 416 U.S. 574, 586 (1983), and *U.S. v. Goodyear Tire and Rubber Co.*, 493 U.S. 132, 139-40 (1989), can the government assert that netting is restricted to

discretionary debt collection setoffs. Interest netting has existed independently of § 6402(a) since 1958 and was already required by law long before Congress adopted differential rates in 1986. In § 1511(b), Congress simply took steps to make clear to the IRS that the implementation of comprehensive netting was essential under the newly instituted differential rate system.

II. The Government Has Failed to Address the Conceptual Conflict Between the Eighth Circuit and Seventh Circuit.

The government's effort to gloss over the conflict between the Eighth Circuit and the Seventh Circuit in *Pettibone* by arguing that all the IRS had attempted to do in *Pettibone* was to collect the "outstanding" individual tax year underpayments is an extension of its erroneous approach of treating collection credits and interest netting credits as one and the same.

In *Pettibone*, if interest on each of the 13 individual tax year underpayments and overpayments involved in the case had been computed separately as of the time of trial, the government would have *owed* the taxpayer more than $250,000. Therefore, even had the IRS been permitted to engage in simple debt collection setoffs under § 6402(a) at the time of trial, that would have yielded a net *refund* to the taxpayer because the IRS would not have been able to charge interest on the underpayments after the date of the bankruptcy petition and until the plan was confirmed.

Instead, in *Pettibone* the government argued for retrospectively combining each of the 13 separate tax year

accounts into one aggregate account which began with the filing of the return for the first of the 13 years and ran forward to the bankruptcy litigation. The government argued that the theory underlying § 6601(f) netting is that overpayments and underpayments cancel themselves out for interest computation purposes "for the period during which such obligations are mutually offsetting." (Petition at 8). Lending full support to NSP's contention that a "credit" for § 6601(f) purposes means an accounting "credit" entry for computing interest, the government in *Pettibone* characterized netting as an accounting method in which an overpayment is a "credit" against an underpayment for interest purposes. The Seventh Circuit agreed and never treated interest netting as merely the consequence of debt collection.

That the government performed, and the Seventh Circuit embraced, interest netting and not debt collection is further confirmed by the methodology employed by the IRS in *Pettibone*. There, the government's interest computation specialist retrospectively combined the 13 separate year accounts into one aggregate account in which each overpayment and underpayment was chronologically applied in the precise historical sequence in which each actually arose. Interest was then applied only to the aggregate net overpayment or net underpayment running balance over the entire history of this single account. This constitutes interest netting, the benefit of which NSP has sought in this case. On the other hand, under raw § 6402(a) debt collection authority, the IRS could have applied *any* overpayment against *any* underpayment in *any* sequence it might have chosen. In *Pettibone*, the IRS did not perform discretionary debt

collection and the Seventh Circuit never characterized the netting exercise as the collection of any "outstanding" debt. In fact, in *Pettibone* the only dispute related to the methodology for computing interest because the parties had fully stipulated individual year tax overpayment and underpayment amounts. *See also* the discussion of the government's interest netting method and its reliance upon § 6601(f) in *In Re Pettibone Corp.*, 161 B.R. 960, 962 (N.D. Ill. 1993). Limiting interest netting to a simple by-product of debt collection under § 6402(a), as the Eighth Circuit has done, is flatly irreconcilable with the Seventh Circuit's decision in *Pettibone*.

CONCLUSION

Congress has acted far more intelligently, rationally, and beneficently than the government and the Eighth Circuit would have it. Since 1958, Congress has legislated fair "use of money" interest netting concepts, unadulterated by IRS discretion, into the interest obligation provisions of the tax law. In 1986, Congress enacted § 1511(b) to insure that the IRS would take the steps necessary to comprehensively implement this already-required netting principle in the context of the differential rate structure then being adopted in § 1511(a) for the first time. In 1990 and 1994, Congress reiterated the need for comprehensive netting, aware as it was on each of those occasions of the IRS' wholesale noncompliance. Only by divorcing themselves from the principles which must guide the statutory analysis have the government and the Eighth Circuit reached a result which validates the IRS' intransigent

refusal to give taxpayers the benefit of netting as Congress intended. This result frustrates the will of Congress, creates gross injury to taxpayers, and, in the end, damages the government itself by breeding disrespect for the administration of the tax laws. The importance of the question, and the issues necessarily raised in resolving it, merit certiorari.

Dated: September 23, 1996

Respectfully submitted,

STEVEN Z. KAPLAN
RICHARD D. SNYDER
FREDRIKSON & BYRON, P.A.
1100 International Centre
900 Second Avenue South
Minneapolis, MN 55402
(612) 347-7000

Attorneys for Petitioners